Supreme Court U.S.
FILED
AUG 1 2002
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(3)

No. 01-1719

IN THE

Supreme Court of the United States

STAR SCIENTIFIC, INC.,

Petitioner,

v.

JERRY W. KILGORE,
in his official capacity as Attorney General,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

REPLY BRIEF

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STATEMENT PURSUANT TO RULE 29.6

Petitioner's Rule 29.6 Statement was set forth at page *ii* of its Petition for a Writ of Certiorari, and there are no amendments to that Statement.

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The Attorney General objects that our characterization of the Qualifying Statute and the Master Settlement Agreement (MSA) scheme is "inaccurate" and "overwrought." (Opp. 11). It is, however, essentially the same — perhaps minus some of our adjectives — as the description offered by the Third Circuit in the antitrust attack on the MSA in *A.D. Bedell Wholesale Co., Inc. v. Phillip Morris, Inc.*, 263 F.3d 239, 246 (2001), *cert. denied*, 122 S. Ct. 813 (2002).

But whether or not Star Scientific's characterization is accepted, the judgment below warrants review by this Court. As the Petition demonstrates, the scheme of the MSA and Qualifying Statute is an unprecedented attempt by the participating jurisdictions to cartelize and regulate a multi-billion dollar national market without the consent of Congress. Though complex and ingenious, the scheme could not achieve this effect without raising important questions about equal protection and the proper meaning of the Compact Clause. Moreover, the scheme conflicts with decisions of this Court and the First Circuit interpreting the Commerce Clause in its dormant state. In upholding the scheme — which was a "landmark outcome" because of the amount of money involved and the fact that it was used to develop nationwide regulatory policy for a multi-billion dollar industry, *see* W. Kip Viscusi, *A Post Mortem on the Cigarette Settlement*, 29 CUMB. L. REV. 523, 523, 545 (1998) — the court of appeals' decision invites the States to use the MSA as a template for regulating and extracting large sums of money from other industries such as paint, firearms, pharmaceuticals and motor vehicles. Indeed, since we filed our Petition for Writ of Certiorari, the Attorney General of New York entered a settlement with Merrill Lynch, Pierce, Fenner & Smith, Inc., in which the company agreed to make changes in its brokerage practices nationwide and to pay $100 million, $48 million of which will be paid to New York, and $50 million of which will be paid to the remaining 49 States, the District of Columbia and Puerto Rico if they agree that the payments resolve

similar claims that they may have against the company.[1] Thus, the Attorney General is wrong to suggest that this is simply a run-of-the-mill case involving nothing more than the application of well-settled legal principles. (Opp. 10).

Equal Protection. Our equal protection challenge to the Qualifying Statute may be stated simply: If Star Scientific must pay, why should not all cigarette manufacturers pay? [2] What the Attorney General must do, and what he fails to do, is explain how the *classification* which imposes the burden on Non-Participating Manufacturers like Star Scientific but not on the Big Four tobacco defendants, who negotiated the MSA, and the small Subsequent Participating Manufacturers, who make no payments at all, is rationally related to some legitimate purpose. It is a light burden, but it is not a meaningless one. And the Attorney General fails to carry it.[3]

As the Petition explains (at 17-20), if the purpose of the Qualifying Statute is the one offered by the Attorney General — to ensure a source of recovery for the "financial burdens" that cigarettes impose on the States (Opp. 12) — then the purpose is legitimate but the *classification* bears no relation to it. The Big Four tobacco companies are at least as likely as Star

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1. This settlement agreement is available at <*http://news.findlaw.com/cnn/docs/merrilllynch/nymerrill52102agr.pdf*>.

2. The Attorney General seems to quarrel with our assertion that the burden is so severe as to deprive Star Scientific of access to all of its net income in the last several years. The case comes to court, however, on a motion to dismiss, and therefore this allegation in the complaint (App. 197a) must be taken as true.

3. The Attorney General complains that we cited equal protection cases involving "discrimination directed against individuals" instead of cases of "economic regulation." (Opp. 14, n.9). The Attorney General apparently overlooked our citation to cases such as *Allegheny Pittsburgh Coal Co. v. County Comm'n of Webster Cty.*, 488 U.S. 336 (1989), that involved so-called "economic regulation." (Pet. 16, 22). In any event, all of the equal protection cases cited in the Petition were decided under rational basis review, which is the same standard of review regardless of whether the case involves economic or social regulation.

Scientific to become insolvent and unable to pay future damage awards, because of their immense potential liability to individual smokers for their past fraudulent and deceptive practices.[4] And if the purpose is to coerce smaller companies to join the MSA and accept its output and marketing restrictions — as the Attorney General repeatedly asserts when he objects that Star Scientific had the Hobson's choice of joining the settlement (Opp. 7, 18) — that purpose is illegitimate. (Pet. 20-22). What is left is the wholly illegitimate purpose acknowledged in the statute itself and in the MSA to which the Attorney General has subscribed: To protect the market share of the Original Participating Manufacturers (that is, the Big Four tobacco manufacturers) so they can continue to make immense payments to the States to settle liability for wrongs with which Star Scientific has not been and could not be charged. As in *Department of Agriculture v. Moreno*, 413 U.S. 528 (1973), the classification is so ill-suited to the legitimate purpose the Attorney General claims it serves that the assertion is incredible, while the illegitimate purpose fits like a glove. The constitutional obligation to govern impartially cannot be shrugged off by such transparent maneuvers.

1. The Attorney General counters that it is rational to impose the escrow obligation only on Non-Participating Manufacturers, because the "Participating Manufacturers . . . have agreed . . . to make equal or larger current payments to the Commonwealth." (Opp.14). That statement is incorrect insofar as it applies to the Subsequent Participating Manufacturers who are not obligated to make *any* payments, provided that they do not take national market share from of the Original Participating Manufacturers. (Pet. 6). Thus even if these Subsequent Participating Manufacturers sell increasing numbers of harmful cigarettes in future years, they will still pay nothing so long as they do not cut into the Big Four's relative market share. Nothing

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4. *See, e.g.*, Gordon Faircloth, *Reynolds Ordered to Pay $15 Million: Scale of Punitive Award Heightens Threat Lawsuits Pose to Tobacco Industry*, WALL ST. J., June 24, 2002, at A6.

more vividly illustrates the actual purpose of the statute and how threadbare are the Attorney General's justifications of it. But even as applied to the Original Participating Manufacturers, the Attorney General's argument is wrong for two reasons.

First, although the MSA requires the Original Participating Manufacturers to make payments to the Settling States in perpetuity, it neither guarantees that they will remain solvent nor requires them to post any security for future damages they have not yet paid. That the Original Participating Manufacturers agreed to make payments in perpetuity is, therefore, irrelevant to Virginia's asserted need to ensure that companies not be "judgment-proof if and when called upon to pay for the damages their products had caused. . . ." (Opp. 4). Instead, this illustrates the lack of nexus between the statutory classification and the Commonwealth's asserted interest: A statute that is supposed to ensure that the Commonwealth can recover the healthcare costs associated with smoking requires security from the Non-Participating Manufacturers who may never be found liable for those costs, but not from the Original Participating Manufacturers whose liability has been conceded.

Second, the Attorney General coyly fails to mention that the MSA settled lawsuits alleging that the Big Four tobacco defendants, for almost fifty years, had engaged in a pattern of consumer fraud, racketeering activity, and antitrust violations to mislead the public about the dangers of smoking and to suppress research and the development of safer cigarettes.[5] (Pet. 2-4). Star Scientific was not a party to those lawsuits and has not been, and could not be, charged with similar violations.

5. Moreover, the Attorney General's assertion that the legislature reasonably could have concluded that Star Scientific "may be found liable" in the future on the theory that "[c]igarettes are inherently dangerous products" — a theory that he acknowledges is "different from those previously asserted against the OPMs" (Opp. 15-16) — is inconsistent with the preamble to the Qualifying Statute. As the Petition explains (at 18-19), the statutory preamble disavows any purpose of recovering, on a strict liability-like basis, for future health care costs caused by cigarettes.

(Pet. 10). Thus, the Attorney General is arguing that because the Original Participating Manufacturers are obligated to make large payments in settlement of claims to which Star Scientific is a stranger, only Star Scientific and other Non-Participating Manufacturers should be obligated to make payments against a *different* set of claims that could hypothetically arise in the future. It is not rational to equate such disparate types of claims.

That disparity is further highlighted by the fact that, as the Commonwealth declared in the Consent Order approving the MSA and the court of appeals accepted (App. 22a), only five percent of the MSA payments are attributable to the Commonwealth's claims for reimbursement for past and future health care costs. Because Star Scientific could not be liable for such past costs (during most of the relevant period it was not even in existence), the Qualifying Statute imposes an escrow payment obligation that is many more than 20 times that necessary to satisfy the Commonwealth's asserted goal of ensuring a source of recovery of future Medicaid costs from Non-Participating Manufacturers that is similar to the recovery it obtained from Participating Manufacturers under the MSA. The Attorney General seeks to avoid the fact that there is no rational basis for such a gross disparity (*see, e.g., BMW of North America v. Gore*, 517 U.S. 559 (1996), *Allegheny Pittsburgh Coal Co. v. County Comm'n of Webster Cty.*, 488 U.S. 336 (1989)) by saying that the Consent Order is meaningless because the Commonwealth "could just as easily have made" a different allocation or "no allocation" at all. (Opp. 17). The argument is desperate. The Commonwealth's description of the MSA payments in the Consent Order may have solved some other difficulty it anticipated with this complicated and ingenious scheme. But the fact remains that the Commonwealth *did* designate the payments in this manner, and it should not now be heard to question the designation. Courts of law are not to be toyed with in this fashion.

2. The Attorney General, like the court of appeals (App. 23a), defends the differential treatment of Non-

Participating Manufacturers on the ground that the Participating Manufacturers have agreed to "significant restrictions" on their conduct. (Opp. 14). Indeed, the Attorney General justifies the statute's failure to require escrow from Subsequent Participating Manufacturers (who pay nothing under the MSA) on the ground that it provided "an incentive" for such companies to join the MSA and "agree to significant advertising and marketing restrictions." (Opp.18). But many of those advertising and marketing restrictions would violate the Constitution if imposed legislatively. (Pet. 20). Thus, the Attorney General's argument not only fails to provide a justification for the statute; it highlights the statute's constitutional infirmity. State legislatures may not impose payment obligations to coerce firms to join settlements and to waive their constitutional rights. *See, e.g.*, Pet. 20-21; *Speiser v. Randall*, 357 U.S. 513, 518 (1958). "For if the government could deny a benefit to a person because of his constitutionally protected speech or associations, his exercise of those freedoms would in effect be penalized and inhibited." *Perry v. Sinderman*, 408 U.S. 593, 597 (1972). The Attorney General's failure even to address this point speaks volumes.

Compact Clause. Star Scientific is "a non-party to the MSA" (Opp. 21), and if that Agreement stood alone, Star Scientific would have no reason, and therefore no standing, to challenge it. But the MSA does not stand alone. It is inextricably linked to the Qualifying Statute that imposes burdensome payment obligations on cigarette manufacturers by explicit reference to the MSA. *See* Va. Code Ann. § 3.1-336.2(A) (App. 73a), and MSA, § IX(d) (requiring Settling States to enact and enforce a Qualifying Statute) (App. 132a-138a).

Thus, Star Scientific is not making a "'bootstrap' attempt to claim standing," as the Attorney General maintains. (Opp. 21a, quoting App. 52a). Instead, the court of appeals correctly found that Star Scientific has standing because the Qualifying Statute imposes an "actual and concrete injury" on Star Scientific that is "'fairly traceable'" to the MSA that "coerced the Commonwealth to enact" the statute. (App. 34a).

This case therefore presents a "similar situation" (App. 35a) to that presented in *Bennett v. Spear*, 520 U.S. 154, 169 (1997), in which this Court held that consumers of water from a federal water project had standing to challenge a Biological Opinion issued by the Fish and Wildlife Service to protect endangered fish because the Opinion had a "powerful coercive effect" on the Bureau of Reclamation, which reduced the water available to plaintiffs to comply with the Opinion. Similarly, the MSA "while not technically *requiring* Virginia to enact a qualifying statute, nevertheless imposes a powerful incentive for it to do so" by imposing "large penalties" if the Commonwealth does not enact the statute. (App. 35a-36a, emphasis in original).

On the merits, the Attorney General asserts that the MSA does not violate the Compact Clause because each "Settling State could have independently settled its claims against the Participating Manufacturers" on terms identical to those included in the MSA. (Opp. 22). This is incorrect. The MSA has several crucial provisions that simply make no sense except in the context of what the court of appeals correctly characterized as the "horizontal aspects . . . implicating the Compact Clause." (App. 37a).

As the MSA expressly states (App. 68a), the Qualifying Statutes are intended to protect the market shares and profitability of Participating Manufacturers, so they can make large damage payments to the Settling States without having their competitive position eroded by Non-Participating Manufacturers who are not required to pay damages. The statutes thus tend to increase the price of cigarettes. If there were no means of ensuring that each Settling State enact and enforce a Qualifying Statute, some Settling States might be tempted to have the best of both worlds: They would not pass a Qualifying Statute, thereby giving their citizens the benefit of lower priced cigarettes from Non-Participating Manufacturers, but they would join the settlement and collect damages from the Participating Manufacturers. This would place the MSA scheme in jeopardy, for the Participating Manufacturers likely would be unwilling

(or unable) to pay billions of dollars to the Settling States in perpetuity if they were not given assurances that their market shares would be protected from erosion by Non-Participating Manufacturers who are not making similar payments.

The Settling States solved this problem by agreeing to enact and enforce Qualifying Statutes and to authorize an independent entity to reduce or eliminate payments to Settling States that fail to comply. The States thus ceded some of their sovereignty to ensure the collective enactment and enforcement of statutes that insure price protection for and protect the *national* market shares of the Original Participating Manufacturers, as well as provide an "incentive" for smaller manufacturers to join the MSA and agree to its *nationwide* restrictions on the advertising and marketing of cigarettes. (Pet. 23). The States could not have achieved such a national regulation of the cigarette market through individual settlements with the tobacco companies.

For these reasons, the MSA is a "combination tending to the increase of political power in the States, which may encroach upon or interfere with the just supremacy of the United States" (*Virginia v. Tennessee*, 148 U.S. 503, 519 (1893)) in the regulation of the multi-billion dollar national cigarette market. Although the Attorney General maintains that this is not the case (Opp. 22), he neither explains how he reached that conclusion nor responds to our argument (Pet. 24) that the Compact Clause is a structural provision that the Framers intended to give the federal government greater protection from interstate compacts than that which the Supremacy Clause already provides. Thus rather than seeking to "invite[] mischief with the Constitution" (Opp. 23), Petitioner is asking this Court to answer "an important federal question that has not been, but should be, settled by this Court." S. Ct. R. 10(c).[6]

6. The Attorney General indicates (Opp. 20 n.13) that if this Petition is granted he would argue that Congress has in fact consented to the MSA. The court of appeals did not reach this issue, but as we demonstrated in our reply brief in that court, the oblique reference to the MSA made in a statute addressing another issue cannot count as the consent of Congress required by the Constitution. (See Pet. 25, n.14).

Commerce Clause. The Attorney General maintains that the court of appeals' decision is consistent with both *Consolidated Cigar v. Reilly*, 218 F.3d 30 (1st Cir. 2000), *rev'd in part on other grounds sub nom., Lorillard Tobacco Co. v. Reilly*, 522 U.S. 525 (2001), and *Healy v. The Beer Institute*, 491 U.S. 324 (1989). This is wrong. As we explained in the Petition (at 26), the Qualifying Statute has the practical effect of barring Star Scientific from selling its cigarettes in non-MSA States at competitive prices that do not include the extra amount needed to satisfy the escrow obligations imposed by MSA States. Because the Qualifying Statute makes the manufacturer (and not the distributor) liable for the payment of escrow on every pack of cigarettes sold in Virginia, Star Scientific can only assure itself against liability and penalties by pricing its product in non-MSA States as if it would be sold into MSA States. It is no answer to say, as the Attorney General does (Opp. 24), that Star Scientific could require out-of-state distributors to record the number of cigarettes they export to Virginia. Finding out after the fact — often too late to avoid the statute's substantial penalties — that a distributor in a non-MSA State exported Star Scientific's product to Virginia does not solve the problem. At that point, the Qualifying Statute makes Star Scientific responsible for the escrow payments, even though the cigarettes were sold in a non-MSA State without taking into effect the cost of the escrow obligation.

Thus, Star Scientific is not arguing that it may not be held liable in Virginia for the harm its product may cause in Virginia, merely because it distributes the product through independent distributors. Contrary to the Attorney General's assertion (Opp. 25), that is a faulty analogy to this case. A manufacturer controls the quality of goods it manufactures and may be held liable for injuries caused to distant consumers with whom it is not in contractual privity. But Star Scientific does not control where independent distributors sell their product. To require Star Scientific to assume such control is

exactly the unconstitutional burden on interstate commerce of which Star Scientific complains.[7]

CONCLUSION

For the foregoing reasons, as well as those stated in the Petition, the petition for certiorari should be granted.

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7. This Court has granted certiorari, 122 S. Ct. 2567 (2002), to review the decision of the First Circuit in *Pharmaceutical Research & Manufacturers of America v. Concannon*, 249 F.3d 66 (2001), No. 01-188. The second question presented in that case is similar to the challenge we make here. There are, however, significant differences between the two cases. First, the *Pharmaceutical Research* case presents important and potentially dispositive questions about the construction of the federal Medicaid statute. Second, the pharmaceutical manufacturers in that case are obliged to accept the restrictions of which they complain as a condition of their participation in the Maine Medicaid program. No such potential market participant or "bitter with the sweet" argument is available to Virginia in this case. Indeed, the First Circuit in *Pharmaceutical Research* did not even refer to its own *Consolidated Cigar* decision on which we rely here.

Respectfully submitted,

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